89-816

No. 89-

In The

Supreme Court of the United States

OCTOBER TERM, 1989

CITY OF LOS ANGELES;
BOARD OF PENSION COMMISSIONERS
OF THE CITY OF LOS ANGELES,
Petitioners,

v.

UNITED FIREFIGHTERS OF LOS ANGELES CITY,
LOCAL 112, IAFF, AFL-CIO;
LOS ANGELES POLICE PROTECTIVE LEAGUE;
RONALD DEAN GRAY; DAVID BACA, JR.;
GREGORY PAUL DUST; BILL G. MCDANIEL;
and FRED A. TREDY,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA SECOND APPELLATE DISTRICT

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QUESTIONS PRESENTED

1. Whether the Contract Clause limits the right of state and local governments to amend statutes defining the level of deferred compensation to be paid to public employees in the form of pension benefits, when such an amendment operates only prospectively and affects no compensation already earned?

2. Whether a legislative judgment about reform of a complex public employee pension system, challenged on the basis of the Contract Clause, is entitled to reasonable deference from the courts, as opposed to the strict scrutiny applied to a purely financial obligation related to a state's entry into the market place?

3. Whether a state or local government has the burden of showing a present "emergency or severe fiscal crisis" in order to justify an amendment to a public employee pension system, even though that amendment is reasonable and necessary to important public purposes?

PARTIES

In addition to the parties listed in the caption, all persons who were active members of the police department or the fire department of the City of Los Angeles on July 1, 1982 and were hired before December 1980 have a financial interest in the outcome of this case, as do their spouses and children.

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In the

Supreme Court of the United States

OCTOBER TERM, 1989

CITY OF LOS ANGELES, *et al.*,
Petitioners,

v.

UNITED FIREFIGHTERS OF LOS ANGELES CITY, *et al.*,
Respondents.

The City of Los Angeles and the Board of Pension Commissioners of the City of Los Angeles hereby petition for issuance of a writ of certiorari to review the decision of the Court of Appeal of the State of California, Second Appellate District, dated April 26, 1989, as modified on May 22, 1989.

OPINIONS BELOW

The order of the California Supreme Court denying review is not reported and is reprinted at Appendix ("App.") 31a. The opinion of the Court of Appeal of the State of California, Second Appellate District, Division One ("Court of Appeal") is reported as modified on denial of rehearing at 210 Cal.App.3d 1095, 259 Cal.Rptr. 65, and is reprinted at App. 1a. The order of the California Superior Court ("the trial court") holding that the pension benefits at issue here are vested contractual rights is unreported and appears at App. 72a. The decision of the trial court rendered at the conclusion of trial is not reported and appears at App. 32a.

JURISDICTION

The Court of Appeal entered its opinion on April 26, 1989, and modified its opinion upon denial of rehearing on May 22, 1989. The California Supreme Court entered its order denying review on July 19, 1989. On October 3, 1989, Justice

O'Connor extended until November 16, 1989, petitioners' time for filing a petition for a writ of certiorari. This Court's jurisdiction is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND CITY CHARTER PROVISIONS INVOLVED

U.S. Const. art. I, § 10, cl. 1:

> "No State shall pass any ... Law impairing the Obligation of Contracts...."

Los Angeles City Charter Art. 17, 18:

The text of these articles appears at App. 81a and 130a.

STATEMENT OF THE CASE

The judgment below declared unconstitutional certain 1982 amendments to Articles 17 and 18 of the Los Angeles City Charter. Charter §§ 184.96(A), 190.143(A) (App. 115a-116a, 192a-193a). Each amendment modified the cost of living allowance ("COLA") that will be paid on retirement to police officers and firefighters. The amendments affected only current employees; they made no change whatever in benefits paid or to be paid to those who retired prior to July 1, 1982. Reporter's Transcript on Appeal ("R.T.") 257:7-8.

The amendments affected the City's Article 17 and Article 18 pension systems. These systems provide pensions to police officers and firefighters hired before December 1980. The pension to be paid is calculated on the basis of years of service: for each year of service up to 20 years a member earns a pension benefit equal to 2% of his or her final salary, and earns at a rate of 3% per year thereafter. A member who retires after 20 years of service will thus receive an annual pension benefit equal to 40% of final salary, a member who retires after 25 years will receive 55% of final salary, and a member who retires after 30 years of service, 70% of final salary. R.T. 247:15-248:14.

Prior to 1966, there was no provision for adjustment of pension benefits for inflation. In that year, the voters adopted a proposal sponsored by the respondent police and fire unions that created a cost of living allowance ("COLA"), but provided that the COLA would be "capped" at 2%. R.T. 247:1-8; 248:15-23. In other words, the "basic benefit" described in the preceding paragraph, which represents the amount paid to an officer in the first year after retirement, would be increased from year to year in proportion to the rise in the Consumer Price Index ("CPI"), provided, that the maximum increase could be only 2% even if the CPI rose by more than that amount.

In 1971, the respondent unions induced the City Council to place on the ballot a measure to eliminate the "cap" from the COLA — in other words, to allow the benefit to increase annually by the full amount of the rise in the CPI. R.T. 574:16-24. This change was projected to cost the City no more than approximately $3.75 million per year, R.T. 582:2-583:5; Clerk's Transcript on Appeal ("C.T.") 2269, and the City Attorney advised the Council, consistent with existing law, that the provision "uncapping" the COLA could be reversed should the future financial condition of the City so require, provided benefits actually earned were protected. R.T. 972:1-23; 982:22-983:8. The voters approved the measure by the narrow margin of 50.99%. R.T. 249:22-250:1.

By 1981, it was clear that the 1971 decision to uncap the COLA was a disastrous mistake. Instead of the $3.75 million that had been projected, by 1982 the uncapped COLA was costing $178 million annually, C.T. 3060, and actuarial estimates rose each year in a way that led the City's managers to conclude that the COLA's costs were not only enormous but essentially impossible to forecast. R.T. 905:22-906:4; 977:26-978:3. Faced with these realities, the Council did exactly what it had been advised in 1971 it could do if the City's condition so required. The Council placed on the ballot a measure, called Charter Amendment H, that

modified the COLA but tailored the modification carefully to apply to *unearned* benefits *only*.

The amendment divided into two parts the pension payable on retirement to a current employee. The first part represented the amount of the pension benefit that had been earned prior to July 1, 1982, the effective date of the amendment. On this portion of the pension, a full, uncapped COLA was payable. Charter Amendment H thus had no effect on *earned* benefits. The second part represented benefits that would derive from service after July 1, 1982 — in other words, benefits that as of the date of Charter Amendment H *had not yet been earned*. On this portion of the pension benefit, the COLA would be either the actual increase in the CPI or 3% per year, whichever was less. R.T. 256:27-257:23. The overall effect of the amendment was thus to reduce slightly the deferred compensation (pension benefits) that would be paid for *future* service, a reduction accomplished by imposing a 3% "cap" on the COLA applicable to pension benefits earned *after* July 1, 1982.

Both before and after Charter Amendment H, Los Angeles police and firefighters were extremely well off. In 1982 the total cost, including pension and salary, for an officer in the Los Angeles Police Department was the highest of any major city in the country. A Los Angeles police officer cost about 50% more, in salary and benefits, than a Los Angeles County deputy sheriff — even though the two do identical work (and in many places work literally across the street from each other) and even though Los Angeles County deputy sheriffs are the *second* most costly police force in the country. C.T. 2422-36; R.T. 651:8-25.

On June 8, 1982, Charter Amendment H was approved by approximately 70% of the voters, R.T. 253:23-27. Respondents filed these lawsuits a few days later.

On June 3, 1983, the Superior Court considered cross-motions for partial summary judgment filed by the parties. The court granted defendants' motion, thereby holding that

pension benefits not yet earned by the rendering of services are not protected by the Contract Clause, U.S. Const. art. I, § 10, cl. 1, and that modifications to such unearned benefits do not raise any constitutional issue. App. 78a.

In October 1983, the California Court of Appeal decided *Pasadena Police Officers Ass'n v. City of Pasadena*, 147 Cal.App.3d 695, 195 Cal.Rptr. 339 (1983), holding that even *unearned* pension benefits were rights protected by the Contract Clause. In light of *Pasadena,* respondents moved for reconsideration of the partial summary judgment for defendants. On November 8, 1985, the Superior Court announced that it would follow the constitutional ruling of the *Pasadena* decision, and accordingly held that respondents' unearned pension benefits were rights protected by the Contract Clause. App. 72a.

Thereafter, in February 1987 the remaining issues were tried. Those issues involved whether, assuming that unearned pension benefits were rights protected by the Contract Clause, Charter Amendment H had unconstitutionally impaired those rights. On March 6, 1987, the Superior Court rendered a decision in favor of plaintiffs, on the ground that impairment could not be justified absent a showing that it was required to prevent a municipal insolvency or similar fiscal emergency. App. 32a, 65a-68a. A declaratory judgment that Charter Amendment H was unconstitutional was entered April 6, 1987. App. 69a.

On April 26, 1989, the California Court of Appeal rendered a decision affirming the trial court's judgment. App. 1a. On May 22, 1989, the Court of Appeal entered an order denying rehearing, modifying the opinion but not the judgment, and certifying its opinion, as modified, for publication. App. 28a. On July 17, 1989, the Supreme Court of California denied review. App. 31a.

HOW THE FEDERAL QUESTIONS WERE RAISED

The federal questions were initially raised by respondents in their original complaints. The Los Angeles Police Protective League asserted in its complaint that the charter provisions at issue "are invalid and violate Article 1, Section 10, Clause 1 of the United States Constitution." The United Firefighters alleged in their complaint that the charter amendments unconstitutionally deprived them of vested contract rights.

The trial court ruled on the federal questions in its March 6, 1987 opinion. Specifically, the trial court held "[t]hat the right to earn pension benefits provided by the City Charter Amendment 2 (effective July 1, 1971), with an uncapped COLA, . . . are vested contractual rights subject to the contract clauses of the United States (U.S. Constitution Art. I, Section 10 Cl. 1) and California (California Constitution Art. I Section 9)" and that the Los Angeles City Charter amendments "are invalid and unenforceable because each of them is a law impairing the obligations of contract within the meaning of Article I Section 9 of the Constitution of the State of California and Article 1 Section 10, Clause 1 of the Constitution of the United States." App. 65a, 68a.

The court below affirmed on the ground, *inter alia*, that there was no justification for any impairment worked by Charter Amendment H because there was no showing of fiscal emergency. The court held, first, that unearned pension benefits are rights protected by the Contract Clause of the U.S. Constitution. App. 3a-8a. In addition, the court held that the trial court correctly concluded that defendants "failed to carry their burden of proving the existence of a genuine emergency or severe fiscal crisis . . . ." App. 22a.

REASONS FOR GRANTING THE PETITION

I. THE COURT OF APPEAL'S HOLDING THAT UNEARNED PENSION BENEFITS WERE RIGHTS PROTECTED BY THE CONTRACT CLAUSE WAS CONTRARY TO LONGSTANDING PRECEDENT OF THIS COURT AND AN UNWARRANTED EXPANSION OF FEDERAL POWER OVER LOCAL GOVERNMENT.

The decision below strikes at the heart of the ability of state and local government to regulate the terms and conditions of public employment. A long and settled line of cases in this Court holds that a statutory provision for public employee compensation will not be construed as a contract: a public employer remains free to modify the statute for the future, provided only that compensation *already earned* is paid. *Dodge v. Board of Education,* 302 U.S. 74 (1937); *Mississippi ex rel. Robertson v. Miller,* 276 U.S. 174 (1928); *Pennie v. Reis,* 132 U.S. 464 (1889); *United States v. Fisher,* 109 U.S. 143 (1883); *Newton v. Commissioners,* 100 U.S. 548, 559 (1880); *Butler v. Pennsylvania,* 51 U.S. 402 (1850). Charter Amendment H did exactly what this Court's cases say the Contract Clause allows. It preserved all pension benefits already earned, but reduced somewhat the rate at which pension benefits could be earned *in the future.* Contrary to this Court's repeated teaching, the court below held that this provision was unconstitutional on the ground that pension benefits, not yet earned by the rendering of services, were rights protected by the Contract Clause, and that those rights had been impaired.[1] App. 3a, 13a.

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[1]Although there are passing references in the Court of Appeal's opinion to the contract clause contained in the California Constitution, the opinion does not clearly and expressly state that the ruling is based on that provision. Rather, it is apparent that the opinion rests primarily on federal law. Under these circumstances, there is no adequate and independent state ground for the decision that defeats the jurisdiction of this Court. Michigan v. Long, 463 U.S. 1032, 1037-44 (1983). More-

The "contract" relied on by the court below derives solely from the provisions of the Los Angeles City Charter for an uncapped COLA, as those provisions existed from 1971 to 1982; this case thus involves no contract in the ordinary sense of a consensual agreement between the parties. The pension provisions of the Charter are merely a small portion of the complex of statutes and ordinances that prescribe the salary, benefits, and other compensation of Los Angeles police officers and firefighters. While recognizing that public employee compensation in general may be modified for the future, the court below held that pension benefits — unlike all other forms of employee compensation — have "the status of a contractual obligation from the moment one accepts public employment," whether or not those benefits have been earned. App. 8a. No principle supports this distinction between pension benefits and other employee compensation, nor did the court below attempt to articulate any basis for the distinction it drew. Candidly characterizing its result as an "anomaly," it said merely that the anomaly was one "sanctioned by the California Supreme Court." App. 8a.[2]

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over, even if the decision were based on the alternative ground of the state constitutional contract clause, review by this Court would still be warranted since it is apparent that the Court of Appeal's interpretation of the scope of the state contract clause is wholly dependent upon its analysis of the scope of protection afforded by the federal clause. *Id.* at 1038 n.4; Zacchini v. Scripps-Howard Broadcasting Co., 433 U.S. 562, 568 (1977). California courts treat the contract clause of the California Constitution as a "parallel proscription" to the federal contract clause. Allen v. Board of Administration, 34 Cal.3d 114, 119, 192 Cal.Rptr. 762, 765, 665 P.2d 534, 537 (1983).

[2]Although the fact is not of critical importance to the issue before this Court, the court below was wrong in its statement of what the California Supreme Court has "sanctioned." No case from that court has ever invalidated a pension modification, like this one, that affects unearned benefits only. Of the cases on which the court below relied, Betts v. Board of Administration, 21 Cal.3d 859, 148 Cal.Rptr. 158 (1983), involved pension modifications made after the employee had left work and which therefore affected *only* earned benefits; while Allen v. City of

Whether the scope of the Contract Clause should be expanded so as to restrict local government in this way, however, is not a question for the California courts, but for this Court. As this Court has stated on numerous occasions, in a case of this nature the initial question that this Court must determine is whether there was a contract within the meaning of the Contract Clause of the Constitution. *Irving Trust Co. v. Day*, 314 U.S. 556, 561 (1942) ("When this Court is asked to invalidate a state statute upon the ground that it impairs the obligation of a contract, the existence of the contract and the nature and extent of its obligation become federal questions . . . [and] finality cannot be accorded to the views of a state court."); *see also Municipal Investors Ass'n v. Birmingham*, 316 U.S. 153, 157 (1942); *United States Mortgage Co. v. Matthews*, 293 U.S. 232, 236 (1934); *Appleby v. City of New York*, 271 U.S. 364, 379 (1926). Nearly one hundred years ago, this Court explained the necessity for and importance of this independent determination:

> "[I]s this court required to accept the principles announced by the state court as to the extent to which the contract clause of the Federal Constitution restricts

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Long Beach, 45 Cal.2d 128, 287 P.2d 765 (1955) and Abbott v. City of Los Angeles, 50 Cal.2d 438, 326 P.2d 484 (1958), involved efforts to modify benefits earned by many years of service. Carman v. Alvord, 31 Cal.3d 318, 182 Cal.Rptr. 506 (1982), did not involve pension legislation at all, but dealt with the construction of Proposition 13, while the holding of Miller v. State of California, 18 Cal.3d 808, 135 Cal.Rptr. 386 (1977), on which the Court of Appeal placed principal reliance, tends rather to support the City's position, since it upholds a change in the retirement age despite the adverse effect of that change on the right to accrue pension benefits. The only California appellate case that *holds* in the same way as the court below is another Court of Appeal decision, Pasadena Police Officers Ass'n v. City of Pasadena, 147 Cal.App.3d 695, 195 Cal.Rptr. 339 (1983), with the reasoning of which the court below ironically did not agree. App. 7a. Both *Pasadena* and the decision below well illustrate the dangers of relying on unanalyzed snippets of cases, rather than their facts and holdings.

> the powers of the state legislatures? Clearly not .... [T]he issue presented makes it necessary to inquire whether that which the defendant asserts to be a contract was a contract of the class to which the Constitution of the United States referred. This Court must determine — indeed, it cannot consistently with its duty refuse to determine — upon its own responsibility, in each case as it arises, whether that which a party seeks to have protected under the contract clause of the Constitution of the United States is a contract the obligation of which is protected by that instrument against hostile state legislation." *Douglas v. Kentucky*, 168 U.S. 488, 500-01 (1897).

Whether unearned pension benefits constitute a contractual obligation within the meaning of the Contract Clause was the central issue for resolution in this case. The result reached by the court below is contrary to longstanding precedent of this Court, and directly in conflict with that reached by the Court of Appeals for the Fourth Circuit in a factually identical case that involved the cost of living provisions of the Maryland teachers retirement system. *Maryland State Teachers Ass'n v. Hughes*, 594 F.Supp. 1353 (D.Md. 1984), *aff'd*, No. 84-2213 (4th Cir. Dec. 5, 1985), App. 211a. The issue presented is important because it affects the ability of local governments to enact needed pension reforms at a time when the problems of pension systems, public and private, are of increasing concern. Failure to allow reform will impose crippling costs on local governments throughout the United States, and interfere with their ability to deliver vitally needed public services. And when a state court reaches out, as the court below did, to strike down a reform approved by 70% of the voters on the basis of a constitutional interpretation that has no support in this Court's precedents, fundamental considerations of federalism and respect for popular sovereignty make it appropriate for this Court to ensure that the state

court cannot wrap its result in the federal Constitution and thus insulate itself from any effective review.

A. This Court Has Ruled That a Public Employer May Reduce the Statutory Compensation to be Paid for Future Services Without Violating the Contract Clause. Charter Amendment H Is Consistent With That Principle.

In *Butler v. Pennsylvania*, 51 U.S. 402 (1850), Pennsylvania Canal Commissioners challenged a statute, passed after they had been appointed to their positions, that reduced their compensation effective from the date of the statute's enactment. Their claim was that the reduction in pay violated the Contract Clause. This Court upheld the legislation, holding that "the appointment to and the tenure of an office created for the public use, *and the regulation of the salary affixed to such an office*, do not fall within the meaning of the [Contract Clause] of the Constitution." 51 U.S. at 417 (emphasis added). The Court carefully distinguished the measure before it, which plainly did not attempt to take away from the commissioners any salary they had already earned, from an effort to reduce compensation for services already performed:

> "The promised compensation for services actually performed and accepted, during the continuance of the particular agency, may undoubtedly be claimed, both upon principles of compact and of equity; but to insist beyond this on the perpetuation of a public policy either useless or detrimental, and upon a reward for acts neither desired nor performed, would appear to be reconcilable with neither common justice nor common sense. The establishment of such a principle would arrest necessarily every thing like progress or improvement in government; or if changes should be ventured upon, the government would have to become one great pension establishment on which to quarter a host of sinecures." 51 U.S. at 416.

See also Dodge v. Board of Education, 302 U.S. at 78-79 ("[A]n act merely fixing salaries of officers creates no contract in their favor and the compensation named may be altered at the will of the legislature."); *United States v. Fisher,* 109 U.S. 143 (1883) (statutory salary in effect when justice took office was not a contract that salary would not be reduced in the future); *Newton v. Commissioners,* 100 U.S. 548, 559 (1880) (the state's police power permits it to "increase or diminish the salary or change the mode of compensation").

The freedom to reduce compensation to be paid for future services does not, of course, entitle a public body to refuse to pay an employee for past services at the statutory rate in effect when the services were performed. In *Mississippi ex rel. Robertson v. Miller,* 276 U.S. 174 (1928), this Court considered a challenge to a Mississippi statute that had the effect of reducing the compensation to be paid to a former state revenue agent for services that had already been provided. The Court ruled that the state could not do so without impairing the obligation of the implied contract that arose in favor of the agent after he had performed his duties and become entitled to the specified compensation. *Id.* at 179. In so ruling, the Court reacknowledged the principle laid down in *Butler* that "the contract clause does not limit the power of a state during the terms of its officers to pass and give effect to laws prescribing for the future the duties to be performed by, or the salaries *or other compensation* to be paid to, them." *Id.* at 178-79 (emphasis added). *See also Fisk v. Jefferson Police Jury,* 116 U.S. 131, 133-34 (1885) ("[T]here is no contract which forbids the legislature or other proper authority to change the rate of compensation or salary for services after the change is made. . . ."); *Arceneaux v. Treen,* 671 F.2d 128, 135 (5th Cir. 1982) ("There is nothing in the meager case law interpreting the contract clause to suggest that it can be invoked to invalidate statutes, regulations, or policies that change conditions or terms of employment for public employees").

These cases firmly establish dual propositions that are controlling here: payment of compensation provided by statute that has been earned by rendering services is a right protected by the Contract Clause; the mere expectancy of continuing to earn compensation at the same level previously provided by statute is not. Those principles apply in this case since it was undisputed — and was expressly recognized by the court below — that pension benefits are a form of deferred compensation. *See* App. 8a. Under the decisions of this Court discussed above, it is clear that the City's provision of a full COLA was not tantamount to an undertaking that the COLA would never be modified or reduced in the future. Rather, the only contractual obligation that can be implied is that the City would pay the full value of pension benefits actually earned by service. Because it fully preserves the value of all COLA benefits earned by service before its effective date, Charter Amendment H infringes no contractual rights within the meaning of the Contract Clause.

B. The Law of California in 1971 Permitted a Public Employer to Reduce the Amount of Compensation to be Paid for Future Services. Any Contract That Arose in 1971 Obligating the City to Provide a Full COLA Necessarily Incorporated That Principle.

In *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977), this Court made plain that there can be no violation of the Contract Clause where a contractual modification is consistent with the law at the time of contracting:

> "The obligations of a contract long have been regarded as including not only the express terms but also the contemporaneous state law pertaining to interpretation and enforcement. 'This Court has said that "the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms."' This principle

> presumes that contracting parties adopt the terms of their bargain in reliance on the law in effect at the time the agreement is reached." 431 U.S. at 19-20 n.17 (citations omitted).

The relevant time in this case is 1971, the date of enactment of the COLA provisions that were modified by Charter Amendment H. But it is clear that in those days even the California courts, consistently with this Court's teaching, held that unearned pension benefits were not protected by the Contract Clause.

In *Kern v. City of Long Beach,* 29 Cal.2d 848, 179 P.2d 799 (1947), the California Supreme Court recognized that pension benefits are a form of deferred compensation analogous to salary and are protected from reduction *to the same extent that salary is protected*:

> "[A]n employee does not earn the right to a full pension until he has completed the prescribed period of service, but he has actually earned some pension rights as soon as he has performed substantial services for his employer. He is not fully compensated upon receiving his salary payments because, in addition, he has then earned certain pension benefits, the payment of which is to be made at a future date.... *[T]he employing governmental body may not deny or impair the contingent liability any more than it can refuse to make the salary payments which are immediately due.* Clearly, it cannot do so after all the contingencies have happened, and in our opinion *it cannot do so at any time after a contractual duty to make salary payments has arisen, since a part of the compensation which the employee has at that time earned consists of his pension rights.*" 29 Cal.2d at 855, 179 P.2d at 803 (citations omitted; emphasis added).

On the other hand, California law has long recognized that a public employer is free to reduce the salary it will pay for future services. *Townsend v. County of Los Angeles,* 49

Cal.App.3d 263, 268, 122 Cal.Rptr. 500, 503 (1975); *Gilbaugh v. Bautzer,* 3 Cal.App.3d 793, 796, 83 Cal.Rptr. 806, 807 (1970); *Brown v. Hanford Elementary School Board,* 263 Cal.App.2d 170, 174-75, 69 Cal.Rptr. 154, 157 (1968); *Kacsur v. Board of Trustees,* 18 Cal.2d 586, 591, 116 P.2d 593, 596 (1941); *Butterworth v. Boyd,* 12 Cal.2d 140, 150, 82 P.2d 434, 439 (1938).

Consistent with these principles, a series of decisions rendered in the years before 1971 held that modification of unearned pension benefits was permissible. *See Houghton v. City of Long Beach,* 164 Cal.App.2d 298, 330 P.2d 918 (1958); *Allstot v. City of Long Beach,* 104 Cal.App.2d 441, 231 P.2d 498 (1951); *[Albion] Allen v. City of Long Beach,* 101 Cal.App.2d 15, 224 P.2d 792 (1950); *Palaske v. City of Long Beach,* 93 Cal.App.2d 120, 208 P.2d 764 (1949).

At issue in those cases was the validity of section 187.1 of the Charter of Long Beach, adopted in 1945. Prior to its adoption, Long Beach provided a pension equal to one half of the final salary of police and fire employees with twenty years' service. Employees who worked more than twenty years had a right to increase their pension benefits, on a graduated scale, from one half of final salary up to a total of two-thirds of final salary. Section 187.1 cut off the worker's right to earn additional pension benefits by further service: an employee with twenty-one years of service on the effective date of section 187.1 received a pension computed on the basis of twenty-one years of service, no matter how many years he continued to work. No employee became entitled, as had been the case prior to the amendment, to a pension equal to two-thirds of his final salary. The new provision thus protected benefits earned as of the effective date of the amendment, but denied any benefits for services rendered thereafter.

Employees repeatedly challenged section 187.1 in an effort to obtain the higher pension to which they would have

been entitled prior to the amendment. The provision was upheld since it protected earned benefits:

> "[I]t was within the power of the city to modify its pension plan to provide that on and after the effective date of the amendment an employee who was entitled to retire might do so or not, as he saw fit, but that if he chose to continue as an employee he could not thereby earn any additional pension above that to which he was entitled on the effective date of the amendment .... [An employee's] contractual right to ... a pension has not been impaired by legislation which, operating prospectively, merely withdraws his right or option to earn a bonus by continuing in employment after he has become eligible for retirement." *Palaske v. City of Long Beach,* 93 Cal.App.2d at 132-33, 208 P.2d at 771.

Accord, Houghton v. City of Long Beach, 164 Cal.App.2d at 308, 330 P.2d at 924; *Allstot v. City of Long Beach,* 104 Cal.App.2d at 443, 231 P.2d at 500; *[Albion] Allen v. City of Long Beach,* 101 Cal.App.2d at 20-21, 224 P.2d at 795.

The clear import of these decisions is that a public employer is free to reduce the amount of pension benefits it will pay for future services so long as the value of all pension benefits earned by service prior to the effective date of the change is fully preserved. Those cases stated the law in 1971 when the City first offered an uncapped COLA, and the principle they establish was thus incorporated into any contract that arose between the City and members of the Article 17 and Article 18 pension systems. *See United States Trust Co. v. New Jersey,* 431 U.S. at 19-20 n.17.[3]

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[3]As its sole response to the contention that in 1971 — when the uncapped COLA was enacted — even California cases did not treat unearned pension benefits as protected by the Contract Clause, the court below stated that "applicable law" *in 1971* was embodied in Miller v. State of California, 18 Cal.3d 808, 135 Cal.Rptr. 386, 557 P.2d 970, and Betts v. Board of Administration, 21 Cal.3d 859, 148 Cal.Rptr. 158, 582 P.2d 614. The court below failed to point out that *Miller* was decided

C. This Court Should Grant Review in Order to Correct the Unwarranted and Unwise Restriction on Pension Reform Imposed by the Ruling Below.

For the reasons discussed, the Court of Appeal's ruling that the plaintiffs in this case had a contractual right to unearned pension benefits within the meaning of the Contract Clause cannot be reconciled with this Court's rulings. Compelling reasons of policy exist for the Court to intervene in this case in order to avert the damage that will be done if the ruling stands.

Pension systems nationwide are in trouble, both public and private. Any pension system that is not fully funded is a transfer of wealth from those who are working to those who are retired; society's ability to pay for such systems depends in the end on whether the working population can afford to support those whose pension it pays. This will become harder and harder. The population 65 and older is expected to increase from about 11% of the population in 1979 to about 22% in 2029 — which means that the ratio of non-retirees to retirees will decline from 9 to 1 to about 3.5 to 1. PRESIDENT'S COMMISSION ON PENSION POLICY, WORKING PAPER: DEMOGRAPHIC SHIFTS AND PROJECTIONS: IMPLICATIONS FOR PENSION SYSTEMS 2-4 (Nov. 1979). In the case of state and local pensions, the relevant ratios will be even worse. State and local government employment nearly doubled from 1960-75, but has grown much less rapidly since. In 1980 there were 9.1 million active members of state and local pension plans, and 2.3 million beneficiaries, for a ratio of beneficiaries to active members of 26%. By 2024, there will be 11.4 million active members — a 24% increase, but there will be 4.5 million retired members — a 94% increase. The dependency ratio (or the ratio of beneficiaries to active members) will thus increase by about 50%. For police and fire plans, the dependency ratio will increase

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in 1977, and *Betts* in 1978 — facts that obviously make a shambles of the court's reasoning as to the law in 1971. App. 11a.

from 42% in 1980 to 67% in 2024; for every three active police officers, there will be two retired ones. URBAN INSTITUTE, THE FUTURE OF STATE AND LOCAL PENSIONS 18-4, 18-6, Tables 18-1, 18-2 (April 1981).

Difficulties are especially severe when a pension system involves an uncapped COLA, and Los Angeles in 1982 was only one of many local governments in that period that found pension reform necessary. Other local governments with cost of living adjustments in their pension plans found that they simply could not afford them, and began to cut back or modify them — Detroit in 1968, San Francisco and Washington State in 1976, Minneapolis and St. Paul in 1980. R. FOGELSON, PENSIONS: THE HIDDEN COSTS OF PUBLIC SAFETY 176 (1984). The Urban Institute reported in 1981 that only two large state or local pension plans then still had an uncapped COLA indexed to the CPI: one was the Los Angeles system involved in this case, the other the Maryland teachers system, where the COLA was capped at 3% by a reform identical to Charter Amendment H. URBAN INSTITUTE, THE FUTURE OF STATE AND LOCAL PENSIONS 2-8, Table 2-4 (1981); *Maryland State Teachers Ass'n v. Hughes,* 594 F.Supp. 1353 (D. Md. 1984).

Los Angeles' situation in 1982 shows the type of difficulties to be expected if reasonable reform is not allowed. By 1982, galloping inflation had forced the pension systems' actuaries to revise their assumptions upward and upward, increasing both the projected liabilities of the system and the level of the City's contribution. C.T. 1814-18, 2766. The level of contributions demanded by the pension board's actuary was rapidly exceeding the City's ability to pay. By 1982, the recommended contribution reached $227 million per year — a figure that was an increase of $56 million, or 30%, from the year before. C.T. 2766. This figure represented 16.5% of the City's *total* budget, 73% of all fire and police payroll, and 92% of *all* the City's property tax revenues. C.T. 2766, 3015, 3024.

City officials were not hasty in reaching the judgment that reform of the pension systems was required. On the contrary, the City acted in response to years of studies and recommendations, from insiders and respected outsiders alike. All found that reform was essential. In particular:

— As early as 1975, the Mayor's Ad Hoc Committee on City Finances reported that Los Angeles was a mature or "aging city" with a "serious financial problem," and that among the "danger signs" were the "mounting costs of City salaries and pensions." C.T. 2476-78, 2498-2507.

— Following passage of Proposition 13 in 1978, the Ad Hoc Committee on City Finances resumed its sessions. It reported that "[a]ction must be taken to reduce the continued and long-range growth in pension costs." C.T. 2602, 2623.

— In 1979, the respected Town Hall of California issued its report on public pensions. It reported that the Los Angeles Fire and Police Pension Systems "threaten[ed] the future ability of the City to provide services for the citizenry." C.T. 2299.

— The City Council's Finance and Revenue Committee reported to the Council in 1979 that pension costs were having a "disastrous impact . . . on the City's ability to provide services." C.T. 2324.

— The State Controller's report for 1979 showed that the Los Angeles police and fire pension system was the most expensive and least well funded system in California, and among the worst in the nation. C.T. 3003-07; R.T. 619:17-20.

— The Ad Hoc Committee on Pension Reform, appointed by the Council in 1979, held extensive hearings and received reports from actuaries and others. It concluded that reform was essential. C.T. 2437-61, 2637-79, 2932-44.

— In 1980, the State Controller reported that the Los Angeles police and fire pension system had "little margin for adverse experience," and that the funding ratio was "dangerously low." C.T. 2718, 2720.

— In 1980, the City Administrative Officer reported to the Council that as a result of pension costs "the long term financial stability of the City is clearly at risk." C.T. 2330.

— In 1981, the Council appointed a Blue Ribbon Task Force on Pension Reform, composed of Southern California's leading experts on pension matters. The Council noted that "[t]he cost of the Fire and Police Pension System is having a critical impact on the financial integrity of the City." C.T. 2341. The Blue Ribbon Task Force held extensive hearings and received numerous studies and reports. C.T. 2737-49. It concluded that reform was overdue and recommended what became Charter Amendment H. C.T. 2351-2436.

What is noteworthy about these studies is that they were *unanimous* in recommending reform, and unanimous in supporting Charter Amendment H. In the late 1970's and early 1980's *no one* thought that Los Angeles could afford to leave the pension system as it was. Charter Amendment H was a reasonable and responsible measure that was designed — and succeeded — in avoiding the kind of pension system meltdown that brought New York to the brink of bankruptcy in the mid-70's and which has afflicted and will afflict many other local governments throughout the country.

The court below struck down Charter Amendment H on the basis of a theory of contractual rights that is contrary to this Court's precedents and contrary to the freedom that this Court has always given local governments to regulate the compensation of their employees. Sensible state courts and commentators alike recognize that local government needs freedom to deal with its pension problems, and that

mechanical application of contract theory in the pension area cannot be justified. *Pineman v. Oechslin,* 195 Conn. 405, 488 A.2d 803 (1985); *Spina v. Consolidated Police & Firemen's Pension Fund Comm'n,* 41 N.J. 391, 197 A.2d 169 (1964); *In re Enrolled Senate Bill 1269,* 389 Mich. 659, 209 N.W.2d 200 (1973); *Public Employee Pensions in Times of Financial Distress,* 90 HARV. L. REV. 992, 1001-02 (1977). This Court needs to review the decision below to ensure that when the situation that struck Los Angeles in 1982 strikes other cities in the future, the mistaken interpretation that the court below put on the federal Constitution will not disable local governments from solving the problems they face.

II. THE COURT OF APPEAL'S RULING THAT CHARTER AMENDMENT H UNCONSTITUTIONALLY IMPAIRED THE CITY'S OBLIGATION TO PROVIDE AN UNCAPPED COLA CONFLICTS WITH RULINGS OF THIS COURT AND WITH A DECISION FROM THE FOURTH CIRCUIT UPHOLDING IDENTICAL PENSION REFORM LEGISLATION ON IDENTICAL FACTS.

The court below held that Charter Amendment H was invalid under the Contract Clause because it impermissibly impaired the obligation of the City to provide an uncapped COLA. Two related aspects of this ruling warrant review by this Court. First, like the trial court, the Court of Appeal declined to give appropriate deference to the legislative determination of need for the pension reform accomplished by Charter Amendment H. Second, even though it paid lip service to the principle that a law impairing a contractual obligation will be upheld if reasonable and necessary to an important public purpose, the court in fact required that the City demonstrate that an actual fiscal emergency necessitated Charter Amendment H. These rulings are inconsistent with this Court's decisions and in direct conflict with the decision in *Maryland State Teachers Ass'n v. Hughes, supra,*

where the Fourth Circuit upheld legislation identical to Charter Amendment H.

A. The Court of Appeal Erroneously Declined to Give Any Deference to the Legislative Determination That Charter Amendment H Was Reasonable and Necessary to Achieve Important Public Purposes.

In *United States Trust Co. v. New Jersey,* 431 U.S. 1 (1977), this Court invalidated the attempted repeal of a statutory covenant enacted to provide security for the holders of bonds issued by the New York Port Authority. In the course of that opinion, the Court explained the appropriate standard of review when a state law was challenged as impairing the obligation of a public contract:

> "The Contract Clause is not an absolute bar to subsequent modification of a State's own financial obligations. As with laws impairing the obligations of private contracts, an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose." *United States Trust Co. v. New Jersey,* 431 U.S. at 25-26.

In this case, the trial court found that Charter Amendment H was enacted to accomplish several important public purposes. App. 61a-62a, 66a. These included the following: (1) preservation of the integrity and soundness of the Article 17 and Article 18 pension systems, to insure that benefits provided by the systems would be funded and paid; (2) elimination of the frequent and unpredictable changes in recommended pension contributions caused by the uncapped COLA in order to improve the City's ability to achieve long-term budgeting; (3) avoidance of cuts in vital services that in the judgment of City officials could not be made without endangering public health, safety and welfare; (4) preservation of the morale of all City employees; (5) protection of the long-range financial health of the City by modification of an obligation that the City ultimately could not sustain; and (6) maintenance of popular support for pen-

sion systems in general. As discussed in Part I(C), *supra*, the record amply demonstrated the importance of these purposes and the necessity for Charter Amendment H.

At trial, moreover, all responsible City officials — including Mayor Bradley and the present and former chairs of the Finance Committee — testified that in their judgment Charter Amendment H was reasonable and necessary to achieve those purposes. Their judgment was backed up by the numerous studies and reports that were admitted. And there was no contrary evidence. Plaintiffs offered no actuary, no economist, no other expert who said Charter Amendment H was unreasonable or unnecessary. *All* the experts who had an opinion — the City Administrative Officer, the Mayor, the present and past Chairmen of the Finance Committee, the actuaries, the economists, the outside commissions whose reports were admitted — testified that Charter Amendment H was reasonable and necessary. No witnesses, expert or non-expert, testified that it was not.

It follows that if *any* deference is given to the views of the responsible City officials, or of the voters who enacted Charter Amendment H, the measure must be upheld. The court below, however, took the view that no deference was owed, on the ground that Charter Amendment H was a modification of the City's own "contract", and that such modifications must be subjected to "careful scrutiny." App. 23a. This refusal to give deference to the legislative judgment was error.

The court below believed that strict scrutiny, rather than deference, was required because of language in *United States Trust* to the effect that "complete" deference is inappropriate when a state's "financial obligation" is involved. App. 16a; *see* 431 U.S. at 25-26. But the complex relationship of a city to its employees who are members of its pension systems cannot be equated with the "financial obligation" involved in *United States Trust*. Indeed, this Court's language in *United States Trust* makes plain that the require-

ment of strict scrutiny applies only when a state enters the commercial marketplace:

> "The truth is, States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons. Hence, instead of there being in the undertaking of a State or city to pay, a reservation of a sovereign right to withhold payment, the contract should be regarded as an assurance that such a right will not be exercised. A promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity." *United States Trust Co. v. New Jersey*, 431 U.S. at 25 n.23 (quoting *Murray v. Charleston*, 96 U.S. 432, 445 (1878)).

Charter Amendment H involved no entry into the marketplace; instead, in setting the terms and conditions of public employment, Los Angeles was acting unquestionably as a sovereign. This Court has long recognized that a state's regulation of its own employees is an area that is critical to its functioning as a sovereign entity:

> "[T]he appointment to and the tenure of an office created for the public use, and the regulation of the salary affixed to such an office, do not fall within the meaning of the section of the Constitution relied on by the plaintiffs in error; do not come within the import of the term *contracts*, or, in other words, the vested, private personal rights thereby intended to be protected. They are functions appropriate to that class of powers and obligations by which governments are enabled, and are called upon, to foster and promote the general good; functions, therefore, which governments cannot be presumed to have surrendered, if indeed they can under any circumstances be justified in surrendering them." *Butler v. Pennsylvania*, 51 U.S. at 417.

The correct standard of review of public employee relationships under the Contract Clause is stated in *Amalgamated Transit Union Local 589 v. Massachusetts,* 666 F.2d 618 (1st Cir. 1981), where the First Circuit reviewed two successive enactments that had drastically altered and restricted the scope of the statutory procedure for modifying the collective bargaining agreement between the plaintiff union and the Massachusetts Bay Transit Authority ("MBTA"), a state agency:

> "The Union argues that Chapters 405 and 581 are not 'reasonable and necessary' because there are other methods available — fare increases for example, that will resolve the MBTA's financial problems. The issue that the Union's claim puts before us is the extent to which we are to defer to the state legislature's judgment on these matters.
>
> "If we judge the legislature's actions 'in the light of the facts made known or generally assumed,' those actions are supportable. The legislature clearly felt that Chapters 405 and 581 represented a necessary response to the problems before it. We cannot disagree. . . . The complex controversies revealed by the conflicting affidavits filed in the district court themselves suggest that there is no 'obvious' alternative to the legislature's approach. Thus, even without engaging in the normal presumptions favoring state legislation, we would conclude that a *legislative judgment that these statutes are both reasonable and necessary is itself a reasonable judgment.*
>
> "We do not believe that *United States Trust* requires the federal courts to go further to reexamine *de novo* all the factors underlying the legislation and to make a totally independent determination about whether a fare increase or some other alternative would have constituted a 'better' statutory solution. It is true that language in *United States Trust* suggests moderately close court scrutiny of legislation that conflicts with prior

> *public* contracts. To be specific, the Court stated that as to *private* contracts, 'in reviewing economic and social regulation . . . courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure. . . . ' But, as to *public* contracts,'complete deference to a legislative assessment of reasonableness and necessity is not appropriate. . . . ' This language itself, however, refers only to the need to avoid 'complete' deference, and it is to be contrasted with the dissent's claim that in Contract Clause cases there should be 'unusual' deference to the lawmaking authority of state governments. The very existence, and nature, of the complex factual controversies revealed in the record before us here support the legislature's judgment even without 'complete' deference." 666 F.2d at 641-42 (citations omitted; emphasis added).

Similarly, in *Maryland State Teachers Ass'n v. Hughes*, 594 F.Supp. 1353 (D.Md. 1984), *aff'd*, No. 84-2213 (4th Cir. Dec. 5, 1985), App. 211a, the court drew a clear distinction between the municipal bond contract involved in *United States Trust* and the retirement and pension systems that were the subject of the litigation before it. *Maryland Teachers* is particularly instructive, since in that case the District Court and the Fourth Circuit upheld against a Contract Clause challenge a Maryland law imposing a 3% cap on the COLA on unearned benefits paid by the Maryland teachers retirement plan — a reform that is *identical* to Charter Amendment H. The court said:

> "In the area of pension reform, unlike the area of municipal bonds, the issues are multifaceted. Projections as to the effect of a particular piece of legislation, like the 1979 Act, are based on actuarial assumptions which may or may not turn out to be accurate. . . .
>
> "The contract herein concerns, not a clear financial obligation, but a complex retirement/pension system. It addresses components of that system, the cost of living

adjustment and the contribution a member must make to the retirement system.

"Therefore, while the court must look carefully at the necessity for the modification to assure itself that the State's self interest is not masking the facts, once the facts are brought to light the court should not act as a super legislature and attempt to second guess which legislative act would have better solved the perceived problem. The legislature has the responsibility and the discretion to act on the facts and information at its disposal." *Maryland State Teachers Ass'n v. Hughes*, 594 F.Supp. at 1371.

The court below failed to follow these principles. Mistakenly believing strict scrutiny was required, it accorded no deference to the substantial record of the City Council's study of the need for Charter Amendment H, or to the legislative conclusion that enactment of the measure was necessary to attain public purposes that the court conceded were important. Review of the decision below is important to resolve the conflict between the California courts and the lower federal courts concerning the appropriate level of deference to the legislative judgment in Contract Clause cases.

B. Legislation Impairing a Public Entity's Obligation Will Be Upheld if it Is Reasonable and Necessary to an Important Public Purpose. The Court of Appeal Impermissibly Restricted That Standard by Requiring the City to Demonstrate That Charter Amendment H Was Necessitated by a Fiscal Emergency.

As discussed, *United States Trust Co. v. New Jersey* holds that impairment of a public contractual obligation is constitutional "if it is reasonable and necessary to serve an important public purpose." 431 U.S. at 25. In *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S.

400 (1983), the Court reaffirmed that rule, couching the standard in slightly different terms:

> "If the state regulation constitutes a substantial impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem." 459 U.S. at 411-12.

Although the court below purported to follow these standards, examination of its opinion indicates that in fact it held the City to a much more restrictive standard, invalidating Charter Amendment H because the City did not carry its "burden of proving the existence of a genuine emergency or severe fiscal crisis of a sort which reasonably and necessarily would be ameliorated by the enactment of charter amendment H." App. 22a. In fact, under this Court's cases, the City had no such burden.

The "emergency or fiscal crisis" standard applied by the court below was derived, of course, from this Court's decision in *Home Building & Loan Ass'n v. Blaisdell,* 290 U.S. 398, 444 (1934). It is plain, however, that this aspect of *Blaisdell* is no longer the law. As the Court said in *Energy Reserves,* following the passage quoted above:

> "Furthermore, since *Blaisdell,* the Court has indicated that the *public purpose need not be addressed to an emergency or temporary situation.* One legitimate state interest is the elimination of unforeseen windfall profits. The requirement of a legitimate public purpose guarantees that the State is exercising its police power, rather than providing a benefit to special interests." 459 U.S. at 412 (citations omitted; emphasis added).

As discussed, Charter Amendment H was enacted to fulfill purposes that both the trial court and the Court of Appeal agreed were important. The broad purpose of Charter Amendment H was to accomplish needed reform *before* the City and the pension systems were plunged into a

financial crisis. The court below made impossible prudent long term management of a troubled pension system by holding that an impairment may be justified *only* if an actual emergency exists. In adopting that standard, the court below departed from the principles stated by this Court in *United States Trust* and *Energy Reserves.* And it compounded its error by also failing to accord proper deference to the City's determination of the need for the legislation.

The result reached by the court below makes little or no practical sense. It is astonishingly shortsighted to insist, as did the court below, that there must be an actual fiscal crisis or emergency in order to justify a pension reform measure designed to head off just such a crisis in the future. Why on earth should the Constitution be held to require that a local government wait for a cyclone before digging a storm cellar?

Once again, the *Maryland Teachers* case sets forth the correct interpretation of this Court's decisions and correctly identifies the proper standard of review. Discussing evidence that the three percent cap imposed on the COLA would help ensure the financial soundness of the retirement system, the court concluded that "[t]here can be no rational argument that the 1984 Act was not prompted by an important and legitimate public purpose. . . ." 594 F. Supp. at 1368. The court noted that "[a] pension system need not be actuarially unsound before a legislature may move to change the system and the benefits it provides its members." *Id.* Since Maryland possessed unlimited taxing power, no contention was or could have been made in that case that the state had exhausted its ability to raise revenues to pay for pension benefits: Maryland faced no immediate "emergency or severe fiscal crisis" in the sense of the court below. Yet that factor was not even discussed. Petitioners submit that the approach followed by the *Maryland* court is consistent with the rulings of this Court, and that the court below erred in requiring the City to assume the burden of demonstrating an "emergency or grave fiscal crisis."

CONCLUSION

For the reasons stated, this Court should issue a writ of certiorari to the California Court of Appeal, and on the merits should reverse the judgment below.

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Respectfully submitted,

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